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As I see

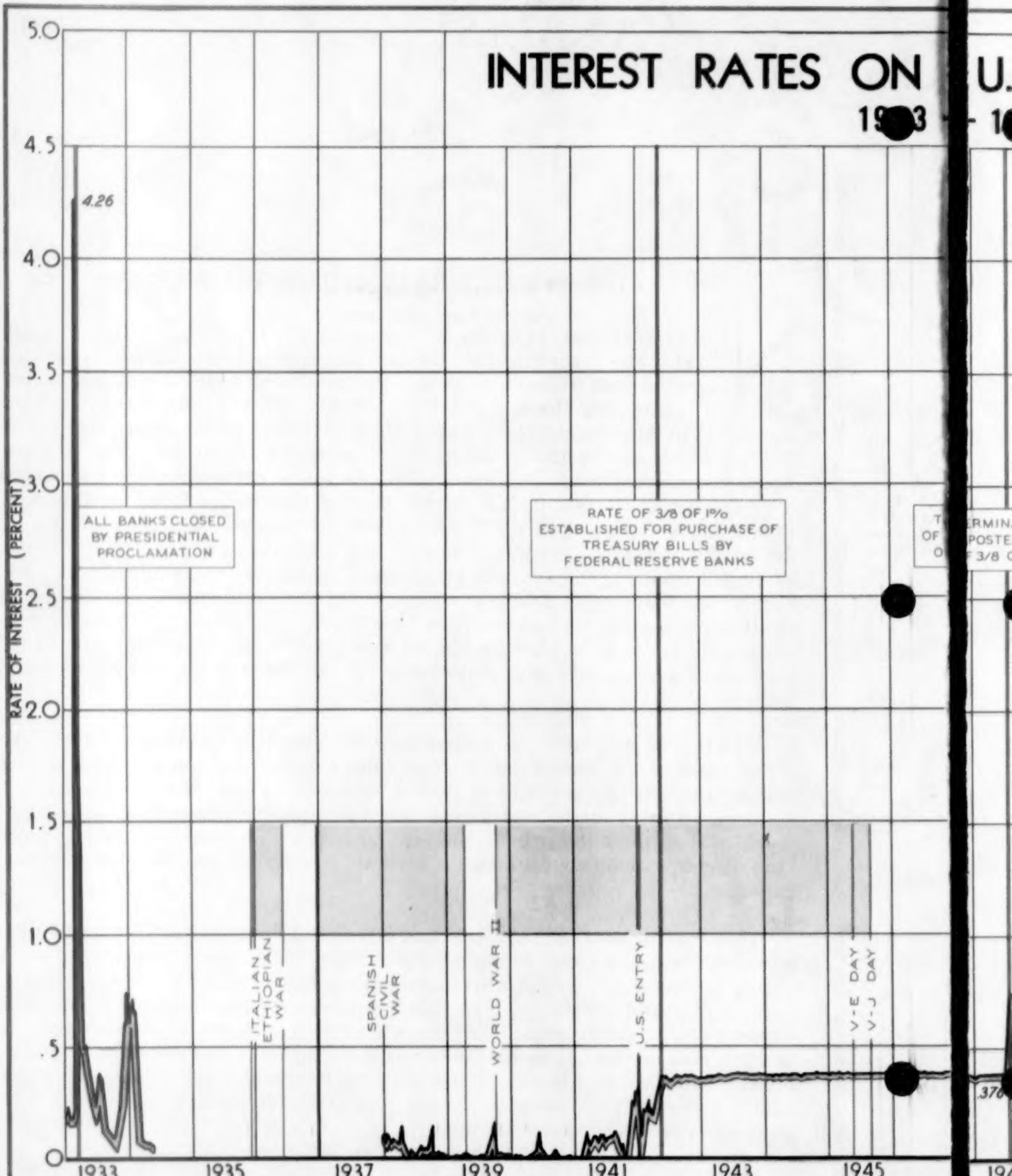
THE INTEREST RATE AND TIGHT MONEY

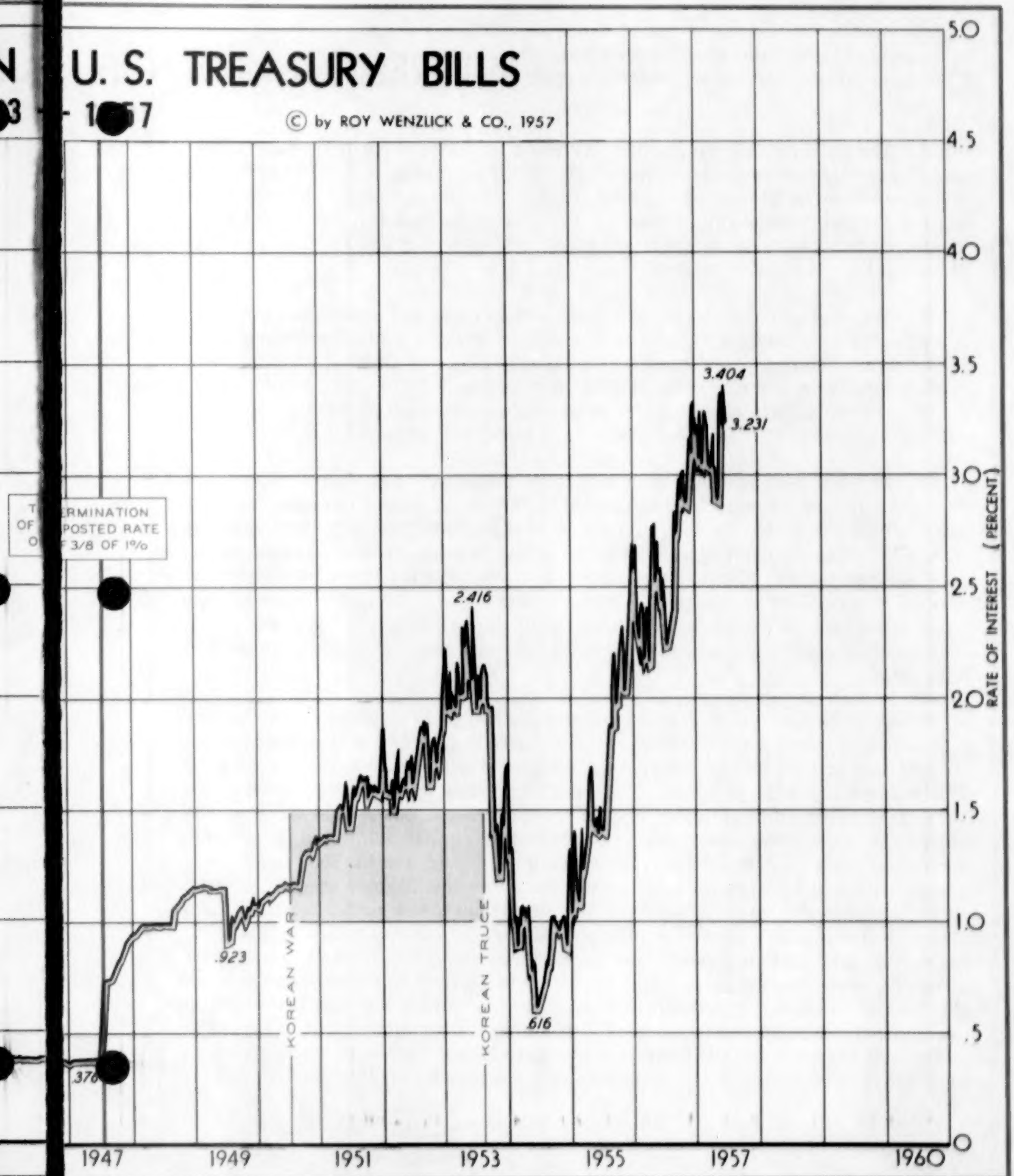
NINETY-ONE-day Treasury bills sold the other day at a price to yield 3.231. The preceding week the average rate at 3.404 had set a new high since the bank collapse of 1933. On the chart which forms the center spread of this report I have shown the average yield of 91-day Treasury bills from 1933 to the present. The weeks in which no figures are shown, no short-term Treasury bills were sold. In red on this chart are shown the significant factors which influenced short-term interest rates. It will be noticed that about 4 months after the United States entry into the war the Federal Reserve Banks established a rate of three-eighths of 1% for Treasury bills, and this rate was maintained until the middle of 1947. This was done as a war measure in order to simplify the raising of money by the Federal Government. It was definitely inflationary, but at that time there seemed no other course, as the winning of the war was paramount to all other issues. Had there been a free market on Treasury bills during this period, there can be no question that the average interest rates these bills would have carried would have been many times the rate fixed by the Federal Reserve Banks.

When the Federal Reserve System freed the market in the middle of 1947, interest rates on short-term bills doubled within a month, and almost tripled in less than a year. From the middle of 1949 to the middle of 1953 they increased about $2\frac{1}{2}$ times. During the following year they had a precipitous drop to about one-fourth of the rate of the year earlier, but from that time to the present they have increased by more than 5 times, without any assurance that the rise has been halted.

This rise in interest rates has had a tremendous effect on the availability of money for mortgages. In the middle of 1954, for instance, mortgages were paying $4\frac{1}{2}$ percentage points above short-term Treasury bills. At the present time, mortgages are paying less than $2\frac{1}{2}$ percentage points above short-term Treasury bills. In view of the fact that when money is loaned on a mortgage there is some risk involved, and that the money is tied up for a long period to be repaid in small amounts each month, there is naturally considerable reluctance on the part of investors to invest in mortgages unless the differential in comparison with more favorable investments is great.

(cont. on page 298)


INTEREST RATES ON U.
19 3 - 1
RATE OF INTEREST (PERCENT)
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
.5
0
4.26
ALL BANKS CLOSED BY PRESIDENTIAL PROCLAMATION
RATE OF 3/8 OF 1% ESTABLISHED FOR PURCHASE OF TREASURY BILLS BY FEDERAL RESERVE BANKS
ITALIAN ETHIOPIAN WAR
SPANISH CIVIL WAR
WORLD WAR II
U.S. ENTRY
V-E DAY
V-J DAY
.376
1933
1935
1937
1939
1941
1943
1945


N U. S. TREASURY BILLS
3 - 1957
© by ROY WENZLICK & CO., 1957
TERMINATION OF POSTED RATE OF 3/8 OF 1%
KOREAN WAR
KOREAN TRUCE
.376
.923
2.416
.616
3.404
3.231
1947
1949
1951
1953
1955
1957
1960
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
.5
0
RATE OF INTEREST (PERCENT)

(cont. from page 295)

Combined with the higher interest rate which mortgage lenders now require have been three other factors which are contributing to a shrinkage in real estate volume.

1. The housing shortage, which was acute in 1947 and the immediate subsequent years, is now much less acute, and in many communities residential vacancy has approached or passed a long-term normal. During a housing shortage, frequently the purchase of residential real estate is not postponable, but as the housing shortage abates it becomes a matter of less consequence if a home cannot be purchased for immediate occupancy.

2. The cost of construction has continued to rise, and since 1939 has risen much faster than other elements in the cost of living. Today, the purchasing power of the dollar for new construction is less than one-third of what it was in 1939, while for goods and services it is about one-half. This means that housing has become relatively more expensive than other elements in the cost of living, and the relative cost of an item will always affect the demand for it.

3. At the same time that the cost of construction has been rising, most cities and close-in communities have exhausted the supply of vacant improved building sites. Those that still remain have taken on a high scarcity value. Competing with these close-in building sites is outlying land needing streets, sewers, water, gas, and electricity. The cost of putting in these utilities has gone up greatly, making it necessary to charge a far higher amount for a building site today than the same site could have been developed for 5, 10, or 15 years ago. In some cases, the values of good residential building sites have doubled, and in some places they have tripled.

There is no easy solution to the present shortage of mortgage funds, and the more obvious solutions which have been advocated, such as lower downpayments on FHA mortgages, longer repayment periods, and an increase in funds for Fannie Mae will not solve the problem. Congress can dictate the terms under which the Federal Housing Administration will insure mortgages, but it cannot compel investors to make these mortgages on conditions which they believe to be unsound, and at too low a rate of interest. It is true that through Fannie Mae direct Government lending on mortgages can be disguised, but the disguise does not prevent its inflationary effects. The sound economic solution to this problem is not glamorous, and probably will not be adopted. Mortgage interest rates on all mortgages, whether FHA-insured or VA-guaranteed, should be allowed to find their own level in the market place. Unless we are to continue to inflate, the period of abnormally low interest rates which we have had during the past few years is over. Real estate should be allowed to compete for the money that is available on the only terms which the owners of savings will consider - an earning rate on their savings competitive with what they could secure from other investments.

ROY WENZLICK